# SEC on SPACs

## New disclosures required and de-SPACs aligned with IPOs

February 2, 2024

## Final rules amend and expand requirements for SPAC IPOs, de-SPAC transactions, and shell companies.

### Source and applicability

- Release Nos. 33-11265; 34-99418; IC-35096; File No. S7-13-22, Special Purpose Acquisition Companies, Shell Companies, and Projections
- Special purpose acquisition companies (SPACs), private operating companies entering into business combinations with SPACs, shell companies, and other SEC registrants using projections

### Fast facts, impacts, actions

The SEC has adopted final rules, and guidance, to enhance investor protections in response to concerns arising from the surge in 2020 and 2021 of SPAC IPOs and the subsequent acquisition of private operating companies (de-SPACs). The final rules and guidance focus on three key areas.

| Enhanced disclosure requirements | Alignment of de-SPACs with IPOs |
|---|---|
| • Require disclosures about:<br>– compensation earned by the sponsor;<br>– material conflicts of interest;<br>– the fairness of the transaction; and<br>– the potential for dilution. | • Moves up the timing of certain nonfinancial disclosures.<br>• Treats the private operating company as a 'co-registrant' in certain filings.<br>• Requires re-evaluation of smaller reporting company status post de-SPAC.<br>• Makes a de-SPAC a 'sale'. |

| Increased transparency in use of projections |
|---|
| • Eliminates certain safe harbor provisions from SPAC-related filings.<br>• Distinguishes between projections based on historical results and those that are not.<br>• Improves clarity when projections include non-GAAP measures.<br>• Specifies disclosures for de-SPACs. |

The final rules are effective 125 days after the date of publication in the Federal Register. Inline XBRL tagging is required for the enhanced disclosures beginning one year after the initial effective date.

## Additional guidance issued

Along with the final rules, the SEC issued guidance and views (not new rules) on several topics, including:

- the use of projected financial information in all SEC filings pursuant to Reg S-K;
- potential underwriter status and liability in de-SPAC transactions;
- determining if a SPAC meets the definition of an investment company under the Investment Company Act of 1940.

## Enhanced disclosure requirements

New Subpart 1600 of Reg S-K requires specialized disclosures for SPAC IPOs and de-SPAC transactions. These requirements codify and standardize certain disclosures already commonly provided by SPACs. However, to the extent the disclosure requirements in Subpart 1600 address the same subject matter as previously existing disclosure requirements of forms or schedules, the requirements of Subpart 1600 are controlling.

### Sponsors and conflicts of interest

Two of the enhanced disclosure requirements focus on the role of a SPAC sponsor and the existence of material conflicts of interest between the SPAC, the SPAC sponsor and other parties. A SPAC sponsor plays a critical role throughout the life cycle of a SPAC; it typically organizes and manages the SPAC, appoints directors and officers, searches for potential targets, and negotiates the terms of and promotes the de-SPAC transaction. Yet, a sponsor's compensation is commonly tied to the completion of a de-SPAC transaction. The depth of involvement between a SPAC and its sponsor is accompanied by potential risks to investors in the form of uneven access to information and conflicts of interest.

Conflicts of interest may exist throughout the life cycle of a SPAC. These conflicts could arise from sources such as a sponsor's compensation being tied to the completion of a de-SPAC transaction, a SPAC entering into a business combination with a target affiliated with the sponsor, and a SPAC's officers having competing responsibilities with other entities. In addition, the likelihood of a material conflict of interest may increase as a SPAC nears the end of its life.

The SEC's final rules seek to provide greater visibility into the experience, roles and responsibilities of a SPAC sponsor. They also aim to shed greater light on potential conflicts of interest. A non-exclusive list of enhanced disclosures are listed in the following table.

| Disclosures related to sponsors | Disclosures related to conflicts of interest (when material) and fiduciary duties |
|---|---|
| • Details of a sponsor's background and experience<br>• Arrangements between the sponsor and SPAC in determining whether to proceed with a de-SPAC transaction<br>• The nature and amounts of all compensation earned or to be earned by a sponsor for its services in connection with the completion of a de-SPAC transaction<br>• Circumstances or arrangements under which the sponsor has or could have transferred ownership | • Actual and potential material conflicts of interest between the SPAC sponsor, officers, directors and unaffiliated investors, including those:<br>– That would influence the SPAC's decision on whether to proceed with a de-SPAC transaction<br>– Arising from the manner of compensation between (1) a SPAC and its officers and directors, (2) a SPAC and the sponsor, and (3) the sponsor and its officers and directors |

| Disclosures related to sponsors | Disclosures related to conflicts of interest (when material) and fiduciary duties |
|---|---|
| • Parties with direct or indirect material interests in the sponsor, and the nature and amounts of their interests<br>• Agreements regarding the redemption of outstanding securities<br>• Tabular disclosure of material terms of any lock-up agreements with the sponsor | • Fiduciary duties that each SPAC officer and director owe to other companies |

### Fairness

Disclosure is required if the law of the SPAC's jurisdiction mandates that the SPAC's board of directors (or a similar governing body) assess whether the de-SPAC transaction and any related financing transaction(s) are fair to the SPAC's unaffiliated shareholders, or make a similar determination. This requirement codifies existing disclosure practices, standardizes disclosure across jurisdictional requirements and increases transparency around the SPAC's merger decisions. Besides explaining its determination, a SPAC also discloses whether any directors voted against, or abstained from voting on, the de-SPAC transaction, along with the reasons for the vote against or abstention.

That statement of fairness also affirmatively identifies whether the SPAC has received a third-party opinion on the fairness of the transaction. If a third-party opinion on fairness has been received, the registrant would have to provide it in its filings.

> The final rules do not require a third-party fairness opinion. However, by requiring an affirmation that a fairness opinion has been obtained, increased scrutiny may be placed on the transaction that have not received such an opinion by investors.

### Dilution

A SPAC investor may experience dilution of the per share value of its investment after the de-SPAC transaction. Dilution may arise from the redemptions of other shareholders, sponsor compensation, underwriting fees, warrants and convertible securities and PIPE financings. The final rules require SPAC registration statements before the de-SPAC transaction (i.e. other than in a Form S-4 or Form F-4 registration statement for de-SPAC transactions) to include descriptions of the material sources of dilution following a SPAC's IPO, as well as tabular disclosure of the amount of potential dilution expected to be absorbed by nonredeeming shareholders to the extent quantifiable.

Specific to de-SPAC transactions (i.e. in the Form S-4 or F-4), the final rules require disclosure of each material potential source of additional dilution that the nonredeeming shareholders may experience during the subsequent phases of a SPAC's life cycle, including disclosure in a tabular format that provides intervals representing selected potential redemption levels that may occur across a reasonably likely range of outcomes.

## Alignment of de-SPAC transactions with IPOs

*Just because a company uses an alternative method to go public does not mean that its investors are any less deserving of time-tested investor protections. IPOs are IPOs, and as Aristotle once said, "treat like cases alike." – Gary Gensler, SEC Chair*

The most significant changes to existing practice in the final rules relate to an effort to align the existing rules and disclosure requirements for de-SPAC transactions with those of traditional IPOs. The final rules are intended to provide investors with substantially the same level of disclosure and liability protections regardless of the path a private entity follows in becoming a public entity.

### Nonfinancial disclosures in de-SPACs

Following a de-SPAC transaction, the registrant is required to file a Form 8-K, often referred to as a 'Super 8-K', disclosing information that would otherwise be required in a Form 10 registration statement. Currently, certain items required under Reg S-K are provided in the Super 8-K following the de-SPAC consummation. Under the final rules, these items must be filed in the Form S-4 or F-4, or Schedule 14A, 14C or TO, for the de-SPAC transaction. Requiring these disclosures earlier provides investors information before deciding whether to vote for the transaction or redeem shares. The items include:

- Item 101: Description of business
- Item 102: Description of property
- Item 103: Legal proceedings
- Item 304: Changes in and disagreements with accountants on accounting and financial disclosure
- Item 403: Security ownership of certain beneficial owners and management, assuming completion of the de-SPAC transaction and any related financing transaction
- Item 701: Recent sales of unregistered securities

Many de-SPAC transactions filed on Forms S-4 or F-4, or on Schedules 14A, 14C or TO, already contain much of the information about the private operating company stipulated in Reg S-K. Under the final rules, all de-SPAC transaction filings are required to provide all of the information typical of an IPO by a private company.

### Minimum dissemination period

The final rules require prospectuses and proxy and information statements filed in connection with de-SPAC transactions to be distributed to shareholders no sooner than 20 calendar days before a shareholder meeting or the earliest date of action by consent.

### Private operating company as a co-registrant

The final rules treat a target private operating company as a co-registrant, which in turn requires its principal officers and a majority of the board of directors to be signatories to Form S-4 or Form F-4 (along with the SPAC's officers and directors, as currently required). This new requirement extends the liability for material misstatements and omissions in the forms to these signatories and the target. The final rules also stipulate that by taking this approach, the target becomes a registrant at effectiveness of that registration statement and therefore is subject to all the reporting requirements of a registrant.

### Redetermination of smaller reporting company (SRC) status

In most cases, the SPAC qualifies as an SRC before the de-SPAC transaction occurs. The final rules require that the post de-SPAC combined company redetermine whether it qualifies as an SRC using:

- its public float as of a date within four days after the consummation of the de-SPAC transaction; and
- the target's revenue from the most recently completed fiscal year reported in the required Form 8-K with Form 10 information post-transaction.

This redetermination is made prior to the time the combined entity makes its first SEC filing. It reflects any change in status in its filings, beginning 45 days after consummation of the de-SPAC transaction.

### Private Securities Litigation Reform Act (PSLRA) safe harbor

The PSLRA provides a safe harbor protecting companies from liability for forward looking statements made in good faith, but it does not apply to statements made in connection with IPOs or 'blank check companies', as defined by the federal securities laws. SPACs generally do not meet the current definition of a blank check company and, therefore, have relied on the safe harbor to provide forward looking statements in de-SPAC transactions. The final rules change the definition of 'blank check company' to include SPACs, which removes the availability of the safe-harbor for SPACs and aligns liability related to forward looking statements, including projections, with those applying to traditional IPOs.

### Underwriter liability

The SEC declined to adopt rules clarifying that the SPAC IPO underwriter is an underwriter for the de-SPAC transaction due to its participation. Instead, it issued guidance emphasizing that a de-SPAC transaction is a distribution of securities and Section 11 liability can apply to anyone acting as an underwriter for a de-SPAC transaction, even if not named as an underwriter in an offering. The guidance clarifies that it is specific to de-SPAC transactions and does not extend to traditional M&A scenarios.

## Business combinations involving shell companies

The final rules require that a business combination of a registered shell company with a private operating company, including a de-SPAC transaction, is deemed as a 'sale' of securities to the shell company's shareholders under the Securities Act. This requirement aligns disclosure and liability of the co-registrants (the SPAC and target private operating company) and their experts with that of a traditional IPO (see Alignment of de-SPAC transactions with IPOs). While the final rules do not prohibit using a valid exemption, the SEC believes exemptions generally would not be available for de-SPAC transactions.

### Financial statements of the target private operating company

The final rules create new Article 15 of Reg S-X to align the reporting required for target private operating companies with those required in registration statements for IPOs, including the following.

| | |
|---|---|
| **Number of years of financial statements** | Permit two years of the target's financial statements in the de-SPAC filing, beyond the predecessor, if the target would qualify as an emerging growth company had they conducted their own IPO. |
| **Audit requirements** | Codify existing staff guidance requiring the financial statements of a target private operating company that is the predecessor in a transaction involving a shell company be audited by a public accounting firm registered with the PCAOB and in accordance with PCAOB standards (because the target is considered a co-registrant to the filing). However, the financial statements of a non-reporting target entity that is not the predecessor may be audited under either PCAOB standards or US GAAS if they are included in the de-SPAC filing. |
| **Age requirements** | Determine staleness of the private operating company's financial statements as if the company were conducting its own IPO. |

### Other business or real estate acquisitions by the predecessor

Financial statements of the target private operating company deemed to be the predecessor are required in the de-SPAC filing. Because the target is a co-registrant under the final rules, it must determine whether it also must include the financial statements of other businesses, including real estate operations, that it has acquired or is probable of acquiring, as required by Reg S-X Rule 3-05, or Rule 3-14 for real estate operations (Rules 8-04 or 8-06, respectively, for SRCs). The SEC believes that this amendment is consistent with current practice.

Further, the final rules require use of the target's (i.e. predecessor's) financial information in the denominator of the significance tests rather than the shell company's (i.e. registrant's) financial information. Absent this amendment, virtually all other acquisitions would be significant. Using the target's financial information in the denominator should produce results more consistent with the sliding scale approach in S-X Rule 3-05 and recognize that certain acquisitions have a greater effect than others.

### Other related amendments

Codifying aspects of current practice, the final rules clarify that a SPAC's financial statements for periods before the de-SPAC transaction may be excluded from SEC filings once (1) the predecessor's financial statements have been filed for all required periods through the merger date, and (2) the financial statements of the combined company include the period in which the merger was consummated.

Another clarification addresses acquisitions of a shell company by a registrant. If a registrant intends to acquire or has already acquired a shell company, the shell company's financial statements are included in any filing that necessitates the registrant's financial statements, as if the shell company were the registrant for the filing. However, this requirement does not apply if the registrant's financial statements already cover the period in which the acquisition of the shell company was completed.

## Enhanced projections disclosures

### Rules to update and expand on the use of projections

Financial projections are a common feature in both SPAC-related and traditional IPO filings. In an effort to drive greater transparency in the use of financial projections in certain SEC filings, the final rules require SPACs to (non-exclusive):

- clearly distinguish projections that are based on historical results from those that are not;
- present historical results and operational history with equal or greater prominence as a projection based on that information; and
- enhance transparency of the use of projections of non-GAAP financial measures, including explaining the non-GAAP financial measure, describing the most closely related GAAP financial measure and explaining why the non-GAAP financial measure was used instead of a GAAP financial measure.

### Rules for filings related to de-SPAC transactions

In addition to eliminating the forward-looking safe harbor provision for SPAC-related projections (see discussion of PSLRA safe harbor), the final rules require the following disclosures, among others, in filings related to a de-SPAC transaction when projections are disclosed:

- the purpose for which the projections were prepared and the party that prepared the projections;
- all material bases of disclosed projections, including material assumptions used to develop projections (specifically including selection and reason for selection of material growth rates or discount multiples used), and any factors that may affect such assumptions included in a de-SPAC transaction; and
- a statement indicating whether the disclosed projections are reflective of the views of management of the SPAC or the target company as of the most recent practicable date prior to the date of the disclosure document required to be disseminated to security holders.

## Investment company considerations: SEC declines to adopt safe harbor

The SEC did not adopt the proposed safe harbor rule that would have allowed a SPAC to avoid determining its status under the Investment Company Act of 1940 (1940 Act) if it complied with certain conditions and disclosures. Instead, the SEC believes SPACs and their sponsors should increase their focus on evaluating when a SPAC could be an investment company subject to the filing and disclosure requirements of the 1940 Act. To this end, the SEC has provided its views on this evaluation.

In assessing an issuer's status as an investment company, the SEC generally looks to the issuer's historical development, public statements on policy, management activities, and the nature of its assets and income sources. For example, prior to a de-SPAC transaction, a SPAC typically invests substantially all of its assets in securities, often for a period that exceeds one year. Therefore, a SPAC's income is generally attributable to its securities holdings during this phase. In this example, the SEC believes the asset composition and source of income may raise concerns about the SPAC's status as an investment company. Consequently, the factors of the SEC's guidance focus on these perspectives as detailed below in the following table.

| | |
|---|---|
| **Asset and income composition** | A SPAC's asset holdings should not weigh heavily in favor of it being an investment company. A SPAC whose assets consist solely of cash items, US government securities and money market funds, and that does not intend to acquire investment securities (as defined in the 1940 Act) is less likely to meet the definition of an investment company. However, a SPAC with significant investment securities could be considered to be primarily engaged in the business of investing, reinvesting, and trading of securities. In addition, a SPAC could be more likely to be considered an investment company should it have income that is substantially derived from investment securities. |
| **Management activities** | SPAC officers, directors, and employees should consider whether management activities are primarily engaged in achieving a de-SPAC transaction or achieving investment returns. Management activities that involve considerable time towards the business of investing, rebalancing, reinvesting or trading in securities could suggest the SPAC is primarily engaged in achieving investment returns that would tend towards the definition of an investment company under the 1940 Act. |
| **Duration** | A SPAC should operate with the goal of completing a de-SPAC transaction within a reasonable timeframe. A SPAC that operates beyond a reasonable timeline may be more indicative of management and operating activities that are consistent with the definition of an investment company. A SPAC should be aware that, depending on facts and circumstances, the risks increase as the departure from duration limits contemplated in similar contexts also increases. |
| **SPAC activities** | A SPAC that holds itself out in a manner that suggests investors should invest in its securities primarily to gain exposure to its portfolio of securities prior to a de-SPAC transaction would likely meet the definition of an investment company under Section 3(a)(1)(A) of the 1940 Act. |
| **Transaction with an Investment Company** | If a SPAC were to engage or propose to engage in a de-SPAC transaction with a target that meets the definition of an investment company, such as a closed-end fund or a business development company, then it is likely to be an investment company under Section 3(a)(1)(A) of the 1940 Act. |

Contributing authors

Erin McCloskey, Drew Rudolph

KPMG Financial Reporting View

kpmg.com/us/frv

This newsletter is part of our Defining Issues® collection of newsletters and articles with insights and news about financial reporting and regulatory developments.

Sign up here to receive news and insights delivered to your mailbox.

kpmg.com/socialmedia